EU Export Subsidy Commitments Not Yet Binding, But Future Uncertain

Historically the European Union has relied on subsidies to export many of their agricultural commodities. The World Trade Organization (WTO) has forced member countries to reduce the volume and value of their subsidies annually until 2000/01. So far, the annual subsidy reductions have not been a binding constraint due to high world prices, which have reduced the need for subsidies. However, the EU may have difficulty meeting 2000/01 subsidy commitment levels for cheese, beef, olive oil, and other milk products (commodities where 1995/96 subsidies were over the 2000/01 commitment levels), unless they change current policies. [Susan Leetmaa]

The Uruguay Round Agreement on Agriculture (URAA) imposed stringent limits on member countries' export subsidies. The mandatory reductions have been of great concern to the European Union (EU), because it depends on export subsidies to export many of its agricultural commodities under their Common Agricultural Policy (CAP). Whether the EU meets its commitments, and how it meets them, is of interest because the United States, which competes in many of the same markets as the EU. Only data for the first year of the implementation period is available. However, these data can provide some insight as to where the EU is having a difficult time meeting the commitments, and where the reductions have not been a problem.

Over the past 2 years, world prices have been high for many commodities that the EU has typically relied on subsidies to export. As a result, subsidies have declined, and in certain cases, the EU has even imposed export taxes. These events were completely unforseen at the time the URAA was being negotiated. If world prices fall, meeting commitments for these goods may become more difficult in the future.

Uruguay Round Agreement on Agriculture

The URAA includes limits on export subsidies. Export subsidies allow countries to export goods on the world market at a price lower than in their domestic markets. This lowers world prices and distorts markets by altering trade patterns and competitiveness between producers. Other exporters face more competition, because export subsidies drive down the prices of their goods. Countries that can afford to subsidize exports can take markets away from efficient, low cost producers. However, importing countries benefit from export subsidies by being able to purchase more of a good at a lower price.

Historically the EU has relied on subsidies to export grain. Grain prices in the EU were maintained above world levels primarily through government intervention purchases and protection from imports. This typically generated more grain than demanded in the EU. To make EU grain competitive on world markets, and hence reduce surplus domestic supplies, the EU offered export subsidies. Most grain exports were subsidized, and government expenditures on export subsidies were often quite large (as can be seen looking at the URAA base period values).

Prior to the URAA, the United States and the EU were the two largest users of export subsidies. The EU needed export subsidies to export its commodities due to high internal price support. The United States chose to employ export subsidies in response to high export subsidies granted by other countries to their producers, mainly the European Union. During the late 1980's the United States and EU were actually engaged in a "subsidy war" where both countries would target subsidized wheat exports to the same markets, partially offsetting each other and driving each other's subsidies higher and higher.

The URAA forced developed countries, such as the United States and the European Union, to reduce the level of budgetary expenditure on export subsidies by 36 percent and to reduce the volume of subsidized exports by 21 percent. These reductions are to be made from the 1986-1990 base period level over the 1995/96-2000/01 marketing year implementation period, on a product specific basis. Developing countries are also required to reduce their export subsidies, but they have a longer implementation period and lower reductions. Member countries' WTO export subsidy schedules specify how many tons of each commodity can be exported with subsidy, and permitted subsidy expenditures for each commodity.

The text of the URAA provides some flexibility between years in terms of subsidy reductions. If a country exceeds its commitments in any of the years two through five, it must reduce subsidy levels in the next year and assure that the total cumulative value of export subsidies and volume of subsidized exports over the entire implementation period is no greater than the totals that would have resulted from full compliance with its subsidy schedules. Member countries must meet their commitments in the last year of the implementation period (2000/01).

In 1992 the EU introduced a reform of its Common Agricultural Policy (CAP). One objective was to lower some of the internal support prices and compensate producers with direct payments. In return, farmers had to reduce their planted area by a government-established set-aside rate. Internal EU grain prices were supposed to decline 30 percent, for which farmers received direct payments from the government as compensation. CAP reform therefore reduced EU expenditures on export subsidies for certain commodities. However, even the European Commission has acknowledged that internal grain prices did not fall as much as planned, so that farmers were overcompensated. At the same time, the Commission continued to rely on subsidies to export grains, though budgetary expenditures were not as large as prior to CAP reform.

EU Notifications to the WTO on Export Subsidies

WTO members are required to notify the WTO Committee on Agriculture concerning their volume of subsidized exports, their expenditures on export subsidies, and the volume of unsubsidized exports, by commodity, as specified in the country schedules. To date, the EU has submitted notification for the 1995/96 marketing year, the first year members were required to reduce subsidies. Provisional notification was received in mid-March and final notification in late July 1997. Thus, notification for the 1996/97 marketing year is not expected until sometime in 1998.

According to European Commission data on budgetary expenditures, EU total expenditures on export subsidies have been declining since 1991. However, expenditures on export subsidies for dairy, beef, and fruits and vegetables have increased over the same period. The EU's official export subsidy notification to the WTO shows that the EU continued to reduce its overall expenditures on export subsidies in 1995/96.

EU Close to Volume Limits for Some Commodities

Although WTO members must reduce the volume of subsidized exports 21 percent over 1995/96-2000/01 period from 1986-90 levels, the 1995/96 volume commitments are roughly 20-30 percent higher than the final 2000/01 commitment levels. Based on the WTO notification for the 1995/96 marketing year, the EU was just under its 1995/96 limit on subsidized export volume for cheese, fresh fruits and vegetables, other milk products, olive oil, poultry meat, and beef (figure 3). However, the EU was over the 2000/01 limit for those goods (figure 4). Of these commodities, those that applied export subsidies to the bulk of their exports (greater than 80 percent) were olive oil, beef meat, other milk products, and cheese (figure 5). Only 50 percent of the EU's poultry and fresh fruit and vegetable exports were subsidized.

The commodities that used the least of their subsidized volume commitments (less than 50 percent of their volume commitment)for 1995/96 were rapeseed (no subsidized exports were reported to the WTO), wheat, butter, and coarse grains. Typically the EU would have subsidized up to their bound volume for wheat and coarse grains. However, global and EU grain markets were tight and prices were high during the 1995/96 marketing year and the EU used less than 50 percent of its value commitment for wheat and coarse grain. The EU did not need to subsidize as much as it had in the past, and in fact world prices were high enough that the EU taxed exports of wheat and barley for much of the marketing year in order to drive down EU prices.

Figure 3
Percentage of 1995/96 Commitment Used

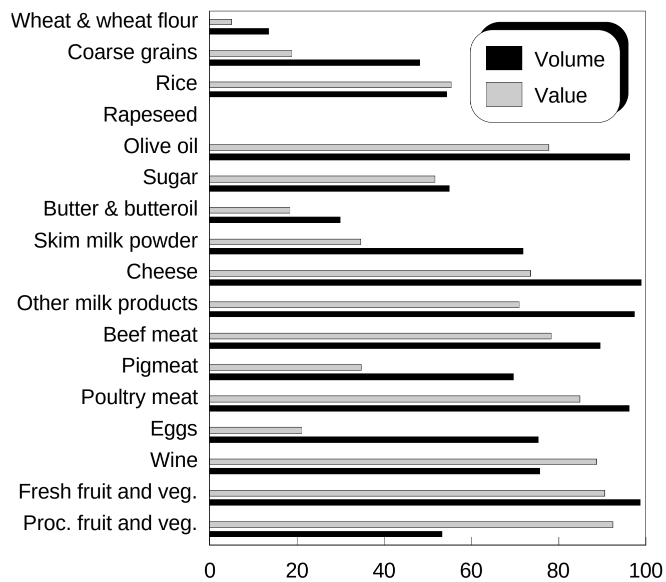


Figure 4
1995/96 Volume as Percentage of Final Commitments

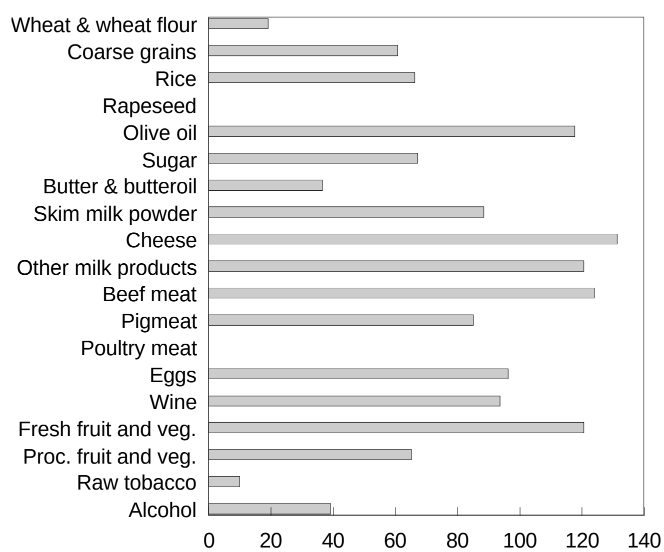
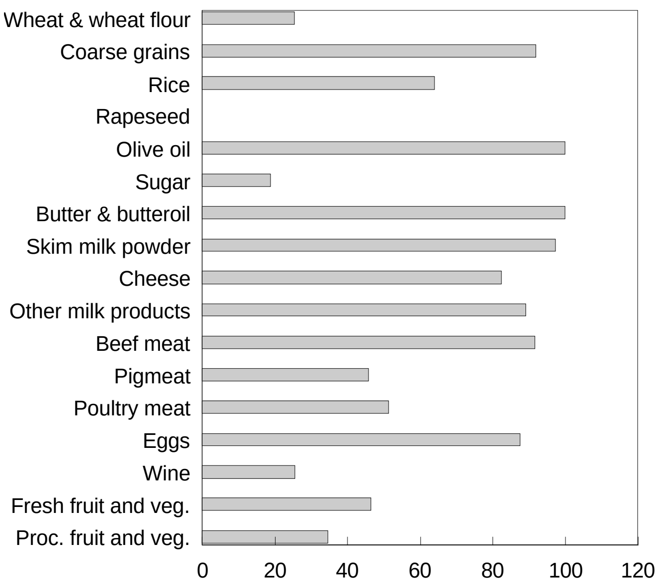


Figure 5
Percentage of 1995/96 Exports Subsidized



Value Limits Were Not Exceeded in 1995/96

In terms of expenditures on export subsidies, the EU was closest to its 1995/96 limit for processed and fresh fruits and vegetables, wine, poultry meat, and beef. Of these, the ECU/ton export subsidy for processed fruits and vegetables was above the average allowable ECU/ton level if the total allowed expenditure was divided by the total allowed volume (table 3). The export subsidies were high partially due to low processed pineapple prices in third countries and to a small black currant harvest that increased EU producer prices. The average per ton expenditure for most commodities was less than the average permitted for the year if the permitted values were divided by permitted volumes.

In 1995/96 EU export subsidy expenditures for certain commodities were very low. Less than 20 percent of the value allotted for export subsidies was used for rapeseed (no exports were subsidized), wheat, butter and butter oil, and coarse grains. Subsidy expenditures were unusually low due to high world grain and butter prices.

Though average subsidies were lower (in value terms) than they could have been, many commodities still required subsidies on the bulk of their exports. The commodities where more than 90 percent of exports received some subsidy were skim milk powder, coarse grains, beef, olive oil and butter and butter oil (figure 5). The EU has always relied on export subsidies for these products because their internal prices are usually maintained at higher levels than world prices.

EU Wants To Carry Over Unused Subsidies

The EU has typically had to rely on export subsidies to export grain due to high price supports. However, during the 1995/96 marketing year world grain prices reached near record highs due to tight global supplies and rising world demand. World grain prices were even higher than internal EU prices, prompting the EU to impose export taxes on wheat and barley to non-EU countries for the first time since 1974. Unlike previous years, only 25 percent of wheat exports were subsidized, whereas 92 percent of coarse grain exports were subsidized. By the end of the 1995/96 marketing year, the EU had used less than 14 percent of its subsidized wheat export volume and 48 percent of its coarse grain export volume. In value terms, the EU had only used 5 and 19 percent of its expenditure commitment to subsidize wheat and coarse grains, respectively.

Because the EU was far below its commitments in 1995/96, some in Europe have argued that the EU has the ability to apply the additional amount not used in 1995/96 to any of the years up to 1999/00. In terms of subsidized export volume, this would mean that the EU could carry over 17.6 million tons of wheat and 7 million tons of subsidized coarse grain exports at 2.2 million ECU and 1.3 million ECU respectively. Others, including the U.S., argue that flexibility provisions in the agreement are meant only to deal with situations where a country exceeds its limits and has to pay back—not as an opportunity for countries to "bank" unused subsidies.

Second Year of Implementation, 1996/97

Though we do not have any official data for the 1996/97 marketing year, which has ended for most commodities subject to export subsidy reductions, ONIC, the French grain office, estimates that EU subsidized wheat exports were roughly 13.6 million tons, still well below the 1996/97 commitment level of 19.2 (before carryover). ONIC estimates for subsidized coarse grain exports were less than 13 million tons, also less than the EU's 13.1 million ton 1996 subsidized export volume commitment. Thus, if the subsidy carryover is permissible, the EU still could subsidize roughly an additional 23.2 million tons of wheat exports and 7 million tons of coarse grain exports above its URAA commitment levels between now and June 30, 2000.

Two major questions arise: Would the EU have the capability to export that much additional grain, and could world markets absorb it? The 1997/98 world wheat crop are forecast to be of record size, and trade is expected to increase for the second year in a row. The EU reintroduced wheat export taxes in July due to appreciation of the dollar relative to European currencies, which makes EU grains more competitive in terms of dollars per ton. However, the increase in grain production has already driven down world prices, and led the EU to reintroduce small export subsidies. If the dollar remains strong, the EU is unlikely to exceed its 1997/98 subsidy allocation. However, if prices continue to fall and the dollar depreciates, the EU will need to increase its export subsidies. This may actually limit the volume that can be subsidized, since the EU has appropriated a fixed

Table 3--EU's WTO Volume and Value Export Subsidy Commitments

Commodity	Base Volume 1986-90 (a)	Schedule commitment 1995/96 (b)	EU notification 1995/96 (c)	Schedule commitment 2000/01 (d)	Value commitment 1995/96 (e)	EU value notification 1995/96 (f)	Permitted value/vol. 1995/96 (e)/(b)	Actual value/vol. 1995/96 (f)/(c)
	--Tons--				--Million ECU--		--ECU/ton--	
Wheat and wheat flour	18,276,000	20,408,100	2,768,800	14,438,000	2,309.0	118.7	113	43
Coarse grains	13,725,600	13,690,200	6,596,400	10,843,200	1,605.7	303.4	117	46
Rice	168,900	163,000	88,600	133,400	54.6	30.3	335	342
Rapeseed	131,400	126,800	0	103,800	40.7	0.0	321	0
Olive oil	145,600	140,500	135,500	115,000	79.8	62.1	568	458
Sugar	1,612,000	1,555,600	856,300	1,273,500	733.1	379.0	471	443
Butter and butteroil	505,500	487,800	146,400	399,300	1,392.1	256.2	2,854	1,750
Skim milk powder	344,900	335,000	241,200	272,500	406.2	140.9	1,213	584
Cheese	406,700	426,500	422,300	321,300	594.1	437.6	1,393	1,036
Other milk products	1,212,800	1,185,400	1,156,700	958,100	1,024.7	727.6	864	629
Beef meat	1,040,100	1,137,000	1,019,100	821,700	1,922.6	1,506.5	1,691	1,478
Pigmeat	561,400	541,800	378,200	443,500	288.8	100.5	533	266
Poultry meat	362,000	434,500	418,100	286,000	136.3	115.9	314	277
Eggs	125,000	126,100	95,100	98,800	60.7	12.9	481	136
Wine	2,917,400	2,851,400	2,161,000	2,304,700	57.5	51.1	20	24
Fruit and vegetables, fresh	953,700	920,300	909,500	753,400	77.6	70.4	84	77
Fruit and vegetables, processed	181,400	175,100	93,600	143,300	12.2	11.3	70	121
Raw tobacco	140,300	190,000	11,200	110,800	96.6	18.2	508	1,625
Alcohol	1,452,400	1,401,600	450,000	1,147,400	141.2	51.2	101	114

Source: EU WTO notification July, 1997

amount of its budget toward export subsidies. Additionally, the United States has only allocated $150 million to the Export Enhancement Program for export subsidies in fiscal 1997/98 and has not used export subsidies for grains for over 1 year.

EU Has Implemented Component Subsidies

Clearly, some of the export subsidy limits have been binding. For example, the EU has started to export some processed cheese under the URAA export subsidy commitments for skim milk powder and butter. The EU claims that this is possible through a modified version of the "Inward Processing Relief" (IPR) system. Traditionally under the IPR, third country products were imported tariff-free, processed in the EU, and then re-exported without subsidy. Neither finished product nor components of the finished product benefited from an export subsidy. However, beginning in February 1997, new rules implemented by the EU recast traditional inward processing to allow the use of export subsidies for components of processed cheese.

The Commission argues that "Inward Processing" increases third country exports to the EU. Non-subsidized components from third countries (such as New Zealand powdered milk) may in some instances also be used. Nevertheless, cheese manufacturers such as New Zealand and the United States fear that the EU will be able to undercut their prices by allocating its export subsidies this way. Additionally, there is the fear that an EU policy of transferring subsidies from one product category to another could spread to other agricultural products, such as using grain export subsidies to produce low cost poultry. This would weaken the WTO's export subsidy commitments, which depend on specific commodity definitions.

Future Prospects and Conclusions

The EU will have to meet the URAA limits on export subsidies by 2000/01. The Commission has discussed some policy revisions that would help it meet these goals. There has been talk of further reducing some of the internally supported prices and providing some direct payments to producers to compensate them for roughly half of the price difference. This type of reform, provided that internal prices actually fall, should reduce export subsidy expenditures.

It is difficult to assess whether the EU will be able to meet its commitments in 2000/01 based on only one year of data, especially a year such as 1995/96 where world prices of many commodities were very high. Based upon the 1995/96 notifications, projected world price levels and exchange rates, the EU will have difficulty meeting 2000/01 subsidy commitment levels for cheese, beef, olive oil, and other milk products (commodities where 1995/96 subsidies were over the 2000/01 commitment levels), unless it changes current policies. According to the official USDA baseline projections, the EU will be able to export wheat without subsidy by 2000/01. Because the EU is a major U.S. competitor in many markets, whether it meets the commitments, and how it does so bears watching.